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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

----In the Matter of ----)
)
PUBLIC UTILITIES COMMISSION)
)
Instituting a Proceeding to Investigate)
the Issues and Requirements Raised)
by, and Contained in, Hawaii Revised)
Statutes 486H, as Amended.)
_____)

DOCKET NO. 05-0002

TESORO HAWAII CORPORATION'S
MOTION FOR RECONSIDERATION OF DECISION AND ORDER NO. 21952;
MEMORANDUM IN SUPPORT OF MOTION;

EXHIBIT A;
AND
CERTIFICATE OF SERVICE

PUBLIC UTILITIES
COMMISSION

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FILED

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TESORO HAWAII CORPORATION

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

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MOTION FOR RECONSIDERATION OF
DECISION AND ORDER NO. 21952

Tesoro Hawaii Corporation (“Tesoro Hawaii”) hereby moves the Public Utilities Commission of the State of Hawaii (“Commission”) to reconsider the Commission’s Decision and Order No. 21952, filed on August 1, 2005 (“D&O 21952”) in the above-referenced docket. This Motion is filed pursuant to the requirements of Title 6 Chapter 61 of the Hawaii Administrative Rules (“HAR”) §§ 6-61-41 and 6-61-137.

Tesoro Hawaii respectfully submits the following grounds upon which it considers D&O 21952 to be subject to the Commission’s reconsideration:

1. D&O 21952 unreasonably and erroneously implements the Twenty-Second State Legislature’s Act 242¹ despite the unacceptably high risks associated with a maximum pre-tax wholesale price cap on the sale of gasoline in Hawaii. Tesoro Hawaii urges the Commission to reconsider instituting the wholesale price cap on gasoline in Hawaii until such time as the risks have been fully mitigated and/or addressed.

¹ Act 242, Session Laws of Hawaii 2004 (“Act 242”). Act 242 became law without the Governor’s signature and has been codified under Hawaii Revised Statutes section 486H, primarily section 486H-13.


2. D&O 21952 unreasonably and erroneously implements the Twenty-Second State Legislature's Act 242 prices for maximum pre-tax wholesale price caps, prices which do not reflect and correlate with competitive market conditions.

3. D&O 21952 unreasonably and erroneously does not consider:

- a. a mechanism to address supply disruptions in Hawaii where an upward price reaction is necessary to increase supply;
- b. a mechanism to correct subsequent errors in source data and inputs; and
- c. a mechanism whereby market participants can recover the costs of compliance with Hawaii's gas cap law.

This Motion is based upon the attached Memorandum in Support of Motion and upon the full record in this proceeding. No hearing on this Motion is requested.²

DATED: Honolulu, Hawaii, August 15, 2005.

By 
Craig I. Nakanishi
Shah J. Bento

Attorneys for
TESORO HAWAII CORPORATION

² Under HAR § 6-61-142, oral argument shall not be allowed on a motion for reconsideration unless requested by the Commission or a Commissioner who concurred in the decision.

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MEMORANDUM IN SUPPORT OF MOTION

TESORO HAWAII CORPORATION ("Tesoro Hawaii") hereby respectfully submits this Memorandum in Support of Motion in support of Tesoro Hawaii Corporation's Motion for Reconsideration of Decision and Order No. 21952 in the above-referenced proceeding.

A. Introduction

On August 1, 2005 the Public Utilities Commission of the State of Hawaii ("Commission") issued Decision and Order No. 21952 ("D&O 21952") relating to Act 242 and maximum pre-tax wholesale gasoline price caps.¹ D&O 21952 will implement maximum pre-tax wholesale gasoline price caps on September 1, 2005. Tesoro Hawaii strongly believes that implementation of D&O 21952 will negatively impact all manufacturers, marketers, jobbers and other wholesalers of motor vehicle fuel throughout the State of Hawaii. Ultimately, Tesoro Hawaii believes that Act 242 will be detrimental to the consumers of Hawaii.

¹ Act 242, Session Laws of Hawaii 2004 ("Act 242"). Act 242 became law without the Governor's signature and has been codified under Hawaii Revised Statutes ("HRS") section 486H, primarily section 486H-13. Although the law was enacted by Hawaii's Twenty-Second Legislature, that body has left it to the Commission to implement its provisions.

HRS § 486H-13(b) specifically requires that “the maximum pre-tax wholesale gasoline prices reflect and correlate with competitive market conditions.”² However, contrary to the statute’s own pronouncements, the legislated price caps set forth in the statute do not correlate with Hawaii’s current competitive market conditions.³

The State’s independent consultants have found Hawaii’s wholesale gasoline market to be competitive, contrary to the Legislature’s findings in Act 242.⁴ Moreover, contrary to public perception, the State’s consultants have also concluded that overall profitability of refiners is not excessive.⁵

The reasons for high prices at the pump in Hawaii are due to:

- high taxes,
- higher cost of living,
- higher cost of doing business,
- higher intrinsic cost of refining operations, and
- higher internal distribution cost.⁶

There is no need for the State to simulate a competitive market where one already exists in the islands. Tesoro Hawaii believes that Hawaii has a competitive wholesale gasoline market. Higher prices are not the fault of manufacturers. Accordingly, Tesoro Hawaii is convinced that a program wherein the government fixes prices is inappropriate.

While Tesoro Hawaii recognizes and appreciates the Commission’s efforts to address and mitigate some of the risks identified by ICF and the parties, such as deaveraging zone

² See also Act 242, Preamble at 3.

³ Tesoro Hawaii does not endorse price caps of any type, including those advanced in the *Implementation Recommendations for Hawaii Revised Statutes Chapter 486H, Gasoline Price Cap Legislation*, ICF Consulting, LLC (“ICF”) (April 15, 2005) (hereinafter referred to as “ICF Report”).

⁴ Stillwater Associates, *Hawaii Fuel Studies-Public Information Briefing* at 6.

⁵ *Id.* at 9.

⁶ Stillwater Associates, *Study of Fuel Prices and Legislative Initiatives for the State of Hawaii* (Aug. 5, 2003) at 89.

adjustments and considering ethanol impacts,⁷ Tesoro Hawaii nevertheless does not believe that a price cap can be fixed or repaired such that it can truly replicate the healthy market atmosphere that now exists in Hawaii.

In this proceeding the Commission and the parties have been bound by an intractable task. While the parties and the Commission can work perhaps to mitigate and delay some of the negative impacts in a government price control scheme, ultimately, efforts to substitute government pricing determinations for the market will fail. As fully set forth in Tesoro Hawaii's Position Statement, government price controls do not work and cause far more harm than good.

B. Reconsideration Based Upon Unacceptable High Risks

Tesoro Hawaii respectfully submits that the gasoline price cap should not be implemented under current conditions. On July 15, 2005, the Commission reported to the Hawaii State Legislature the following risks that can result from implementing Act 242:

- increased risk of gasoline supply shortages;
- increased risk of refinery closure;
- increased risk of wholesale marketers deciding to cease operations;
- increased risk of smaller, remote stations losing supply;
- increased risk of reduced investment; and
- increased risk and uncertainty due to ethanol blending requirements.⁸

The Commission has been informed that "there may be significant conditions that may adversely impact gasoline consumers in the State of Hawaii" and has reported its concerns to the

⁷ See D&O 21952 at 3. Tesoro Hawaii identified the problems with both of these issues in its Position Statement at 3-4 & 18-19. Tesoro Hawaii cautioned that determining the costs to service a particular zone is an impracticable exercise when one tries to apply average industry costs to a market with variable costs of service. Applying average cost concepts means, among other things, that service providers to low volume and small delivery size areas, i.e., rural "Mom and Pop" retailers, would become especially vulnerable. Tesoro Hawaii also pointed out that ethanol blending into gasoline is expected to generate additional capital requirements as well as manufacturing and operational issues. Act 242 does not contain any allowance for the capital requirements of the ethanol mandate.

⁸ Letter from Commission to President Bunda and Speaker Say dated July 15, 2005, attached as Exhibit A.

Hawaii Legislature as required by Haw. Rev. Stat. § 486H-13(n).⁹ Tesoro Hawaii highlighted these risks in its Position Statement. The risks which Tesoro Hawaii outlined may result in a reduction in the number of competitors in the Hawaii marketplace, and consequently the legislation may produce an effect in conflict with the intention to simulate a competitive marketplace.¹⁰

The risks are unacceptably high and argue strongly against the implementation of Act 242. Accordingly, Tesoro Hawaii requests that the Commission reconsider D&O 21952 in light of the unacceptable risk that will be faced by the State of Hawaii under a gasoline price cap regime. To the fullest extent possible, Tesoro Hawaii urges the Commission to reconsider implementation until such time as the risks have been fully mitigated and/or addressed.

C. The Legislature's Pricing Determinations Violate the Statutory Principle that the Wholesale Price Caps Must Reflect and Correlate with Competitive Market Conditions

The parties cannot query the Legislature on the sources and support for the pricing scheme set forth in Act 242. The baseline price, location adjustment factor, marketing margin factor and Premium and Midgrade adjustments have all been "set" by the Legislature. The source of the Legislature's "expertise" in the field of petroleum pricing as well as the source and legitimacy of its authority to make such decisions for private companies suffer from infirmities.

Indeed, the Commission's subject matter expert ICF affirmatively concludes that the Legislature's pricing is inappropriate. ICF's proposals were subject to the tests and scrutiny afforded in this docket, and as another complex and flawed price control scheme, rightfully rejected by the Commission. However, ICF's conclusions and criticisms with respect to the Legislature's default pricing contained in Act 242 continue to have validity.

⁹ Letter at 1. See also D&O 21952 at 10.

¹⁰ Indeed, as the Commission's consultant warns, "Since the total number of suppliers in Hawaii is small to begin with, the attrition of any marketers due to the Gas Cap impact needs to be quickly understood to minimize supply issues to consumers." ICF Report at 75.

In response to Tesoro Hawaii's information requests, ICF made the following observations when asked about the steps it had taken to validate the Legislature's pricing factors set forth in Act 242.

"ICF's evaluation of the **baseline factor** as detailed in the Legislation was done by a historical analysis of the OPIS data as defined in the Legislation. ICF's opinion of the baseline sources in the Legislation was that it appeared **inappropriate** to be basing the Hawaii source price on locations which have been and will continue to be importing significant quantities of gasoline."¹¹

* * *

"The **location adjustment** factor proposed b[y] the Legislation (4cpg) appeared **extraordinarily low** when compared to ICF personnel's experience in costs to move product from the USGC to the USWC, and obviously Hawaii would be greater. ICF's thinking was more like 10 cpg. ICF sought published historical data to demonstrate this, and found that there is nothing published by any major pricing service for US flag vessels. ICF was able to get some quarterly data from a marine company.... The **substantial difference** from the Legislated location adjustment provided validation that the numbers needed to be reworked."¹²

* * *

"There were several concerns about the **marketing margin factor**. One, there was **no documentation** on where it came from, or for what class of trade it applied to."¹³

The Commission correctly rejects a pricing scheme proposed by ICF. As the Commission observes, ICF did not provide the Commission with "any assurance that its factors would correlate better with competitive market conditions than the factors provided by HRS Section 486H-13(b)."¹⁴ In general, except for zone price adjustments, this reasoning can be extended to each instance where the Commission has rejected the ICF proposal.

On the other hand, this is not to say that the Commission has thereby validated the Legislature's pricing factors in Act 242. The default provisions are simply all that are left. Of

¹¹ ICF Responses to Tesoro Hawaii, Tesoro-IR-59 a) at 61 (emphasis added).

¹² ICF Responses to Tesoro Hawaii, Tesoro-IR-59 b) at 61 (emphasis added).

¹³ ICF Responses to Tesoro Hawaii, Tesoro-IR-59 c) at 61 (emphasis added).

¹⁴ D&O 21952 at 18.

course, the parties opposing price caps outright cannot suggest alternative factors under the current law without tacitly supporting price caps.

The issues that have been raised by the parties and the Commission's own consultant ICF in this proceeding are very complex. The Commission's consultant ICF, the parties, and members of the public have raised numerous unresolved issues and unanswered questions with regard to Act 242 which warrant more study. However, Tesoro Hawaii's position continues to be that the task of simulating a competitive market through government price control is a task that is inherently likely to fail. As ICF states, "Gas Cap legislation is still a disruption of the free market system."¹⁵

Tesoro Hawaii respectfully submits that the Commission can take steps on reconsideration to determine that the legislated factors provided by HRS Section 486H-13 are flawed and that no price cap should be implemented until such time as conditions "reflect and correlate with competitive market conditions" as required by Haw. Rev. Stat. § 486H-13(b).

D. The Commission Should Consider Additional Mechanisms

Tesoro Hawaii does not support price caps and does not believe that it is possible to "fix" a government price cap regime. The following mechanisms are requested for the Commission's reconsideration based merely upon the need for some measure of market correction, in order to address plain error, and to impart fairness to all participants.

Tesoro Hawaii raised the following concerns in its Position Statement that it requests the Commission reconsider addressing:

1. supply disruptions in Hawaii where an upward price reaction is necessary to increase supply,¹⁶

¹⁵ ICF Report at 76.

¹⁶ Position Statement of Tesoro Hawaii Corporation at 12-13.

2. subsequent errors in source data and inputs,¹⁷ and
3. recovery of the costs of compliance with Act 242.¹⁸

Supply disruptions require an upward price reaction in order to increase supply and incentivize the marketplace. This reaction is a necessary correction for aberrations brought about by the destruction of fundamental market forces that normally would work in Hawaii but for the implementation of Act 242.

Errors in source data, especially in the publication and tracking of Oil Price Information Service or other data used by the Commission, need to be addressed. In the event of correction to source documents and data, there should be a corresponding reaction in the “virtual marketplace” that is represented by the gas cap.

The cost of compliance is an unrecovered cost that no market participant would have to bear but for the passage of Act 242. While Act 242 seeks to impose wholesale price controls, it is silent with respect to the costs to participants of implementing the program. All parties and the Commission’s consultant have warned of sustainability and viability of wholesale market participants under a gasoline price cap structure. In order to contribute to sustainability and viability of the market participants, and to temper Hawaii’s anti-business reputation, a mechanism should be examined to determine how significant compliance costs are and how best to recover them.

D&O 21952 informs the parties that the Commission will establish subsequent schedules and procedures in this docket, which shall include, but not be limited to, ethanol and classes of

¹⁷ Position Statement of Tesoro Hawaii Corporation at 13.

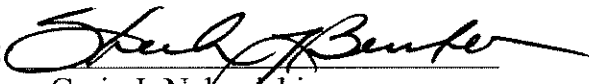
¹⁸ Position Statement of Tesoro Hawaii Corporation at 20.

trade considerations.¹⁹ Upon reconsideration, Tesoro Hawaii requests that the Commission include the enumerated issues above for consideration in further proceedings.

E. Conclusion

In light of the foregoing, as requested in its Motion for Reconsideration, Tesoro Hawaii respectfully moves the Commission to reconsider D&O 21952 and issue the relief requested.

DATED: Honolulu, Hawaii, August 15, 2005.

By: 
Craig I. Nakanishi
Shah J. Bento

Attorneys for
TESORO HAWAII CORPORATION

¹⁹ D&O 21952 at 20.

EXHIBIT “A”

LINDA LINGLE
GOVERNOR



STATE OF HAWAII
PUBLIC UTILITIES COMMISSION
DEPARTMENT OF BUDGET AND FINANCE
465 S. KING STREET, #103
HONOLULU, HAWAII 96813

CARLITO P. CALIBOSO
CHAIRMAN

WAYNE H. KIMURA
COMMISSIONER

JANET E. KAWELO
COMMISSIONER

July 15, 2005

The Honorable Robert Bunda
Senate President
Hawaii State Legislature
Hawaii State Capitol, Room 003
415 South Beretania Street
Honolulu, Hawaii 96813

The Honorable Calvin Y. Say
Speaker of the House
Hawaii State Legislature
Hawaii State Capitol, Room 431
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Docket No. 05-0002 – In the Matter of the Public Utilities Commission Instituting a Proceeding to Investigate the Issues and Requirements Raised by, and Contained in, Hawaii Revised Statutes ("HRS") Chapter 486H, as Amended (aka, Gasoline Price Cap Law)

Dear President Bunda and Speaker Say:

Pursuant to HRS § 486H-13(n),¹ the Public Utilities Commission ("Commission") respectfully submits this report informing you and Governor Linda Lingle (by separate letter) that we have been informed that there may be significant conditions that may adversely impact gasoline consumers in the State of Hawaii ("State") as a result of implementing the Gasoline Price Cap Law on September 1, 2005.

¹HRS § 486H-13(n) states: "The commission shall report to the governor and the legislature, in a timely manner, on any significant aberrations, trends, or conditions that may adversely impact the gasoline consumers in the State."

EXHIBIT A

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The Commission's investigation examining the issues and requirements raised by and contained in the Gasoline Price Cap Law in Docket No. 05-0002 is ongoing. The Parties² participating in this proceeding and the Commission's consultant, ICF Consulting, LLC ("ICF"), have stated that there may be substantial concerns and risks associated with the implementation of the gas price caps as required under the Gasoline Price Cap Law, effective September 1, 2005. These concerns and risks are set forth in the record, and are included in the Parties' respective Statements of Position, filed on July 1, 2005, and Rebuttal Statements, filed on July 11, 2005 and in ICF's April 15, 2005 Report to the Commission, copies of which are enclosed for your reference.

The risks and concerns identified by the Parties and ICF include, but are not limited to:

- Increased Risk of Gasoline Supply Shortages.

Parties assert that gas price caps, by definition, constrain prices, and as a result, businesses operating under price caps may not be able to earn normal returns. Under such conditions, gasoline supply shortages may occur, which could lead to product outages at particular stations. In addition, there may be instances when the gas price cap formula's baseline price and the location adjustment factor are lower than a local refiner's export opportunity, making exporting gasoline more attractive to refiners than selling it in Hawaii.

According to ICF, any outages at Hawaii's refineries may locally affect supply and inventory, but the gas cap would not change because Hawaii's problem likely would not impact the outside markets on which the gas price cap is based. If imports are needed to make up the lost volume, the inability to raise prices beyond the gas price cap may blunt economic replenishment and jeopardize supply.

- Increased Risk of a Refinery Closure.

Parties state that the economic viability of the State's refiners would be threatened if they were unable to generate an adequate return on investment. At that point, it would no longer make economic sense for them to refine gasoline on

²The Parties to the docket are the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs; Chevron USA; Tesoro Hawaii Corporation; Shell Oil Company; and the Hawaii Petroleum Marketers Association.

Oahu. In addition, ICF notes that changes, including the ethanol mandate starting in 2006, which could require refiners to reduce gasoline production to manage supply, may push Hawaii's refiners to closely examine refinery profitability and sustainability.

- Increased Risk of Wholesale Marketers Deciding to Cease Operations.

According to the Parties, if the proposed gas price caps do not cover wholesale marketing costs (including truck delivery for dealer tankwagon class of trade) and provide a reasonable profit margin, some wholesale marketers may choose to cease operations. The consequences of this action would be a reduction of, rather than an increase in, wholesale competition in Hawaii.

- Increased Risk of Smaller, Remote Stations Losing Supply.

Parties maintain that higher costs in areas on the neighbor islands and in remote areas on Oahu may lead to closure of service stations if the gas price cap is implemented. Stated another way, if gasoline marketers in Hawaii find that, under the proposed gas price caps, some distribution channels do not provide an economic return, they may reduce or eliminate sales through those channels.

- Increased Risk of Reduced Investment.

Recognizing that the petroleum industry is extremely capital intensive, from the cost of refineries to capital tied up in inventories and receivables and the cost of retail stations, Parties argue that to the extent a price ceiling is restrictive, it is likely to discourage investment. One of the market implications of imposing a regulated price ceiling is reduced local investment if a better return can be obtained elsewhere. Parties also claim that sellers may look to other sources of revenue that are not regulated (surcharges, credit processing fees, etc.), services previously provided may be reduced or eliminated (reduced delivery schedules, advertising and marketing programs may be eliminated, etc.), or investment at service stations, terminals or refineries may decline or no longer be viable at all.

- Increased Risk and Uncertainty Due to the Ethanol Blending Requirements.

Compounding the uncertainty of the gas price cap impacts are State ethanol blending mandates that go into effect in April 2006. ICF noted that the impacts of ethanol blending are clearly a factor which may need to be considered by the

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Commission in future gas cap management. It also expressed concerns, in response to an information request, that "the marketers, refiners, and consumers in Hawaii may be approaching a confluence of regulatory actions involving both the gas caps and ethanol which will likely create high business and capital investment uncertainty, as well as possible supply concerns."

For your information, the Commission's next step in our investigatory proceeding, noted above as Docket No. 05-0002, is to consider the entire record including, without limitation, the information provided by the Parties and ICF, and render a decision on the issues and requirements raised in this proceeding prior to September 1, 2005. For any procedural questions, please do not hesitate to contact Brooke Kane, Administrative Director, at 586-2276 or Kris Nakagawa, Chief Legal Counsel, at 586-2180.

Sincerely,



Carlito P. Caliboso
Chairman

CPC:LYK:ac

Enclosures

- c: The Honorable Ron Menor (w/ enc.)
 The Honorable Kenneth T. Hiraki (w/ enc.)
 The Honorable Georgina K. Kawamura (w/o enc.)
 The Honorable Theodore E. Liu (w/o enc.)
 ✓Docket No. 05-0002 Parties (w/o enc.)

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Tesoro Hawaii Corporation's Motion for Reconsideration of Decision and Order No. 21952; Memorandum in Support of Motion; Exhibit A upon the following parties, by causing a copy hereof to be mailed via U.S. Mail, postage prepaid, and properly addressed to each such party.

Department of Commerce and Consumer Affairs (2 copies)
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Dated: Honolulu, Hawaii, August 15, 2005.



Sue Iwashita